

### III.B.1.c

MEMO TO: City Council

FROM: Lenda Crawford, Finance Director

DATE: October 7, 2003

SUBJECT: **STAFF REPORT: Financial Status Report for the period  
ending June 30, 2003**

City financial policies require periodic financial reports that summarize activity by major fund type. Accordingly, this report summarizes the financial performance of the major city funds, including the General, Capital and Enterprise funds for the first six months of the 2003 – 2004 biennium.

Staff will be present at the October 7 Council meeting to answer any questions on the report. If you have questions prior to that time, please contact either Lenda Crawford at 425.556.2160 or Martin Chaw at 425.556.2165.

## EXECUTIVE SUMMARY

Although signs of a recovery are beginning to appear at the national level, the regional economy remains weak. This is not surprising, as historically, Washington State has tended to lag behind national trends by six to nine months. The national economy as measured by the Gross Domestic Product (GDP) grew by 3.1% during the second quarter. This is an improvement over the first quarter when GDP was up only 1.4%. Tempering the recovery at the national and local levels is a weak labor market. As of June 2003, the national unemployment rate stood at 6.4%. According to the Bureau of Labor Statistics, the labor market is the weakest it has been in the past 40 years with the Northwest region of the country faring the poorest. Currently, Washington State's unemployment rate stands at 7.8% and is exceeded only by Alaska (7.9%) and Oregon (8.5%).

Despite the fact that the state's high unemployment continues to pose a risk in the short-term, the long-term outlook for the Puget Sound region and the City of Redmond is positive. Microsoft, the City's largest employer, is still hiring and is partially offsetting layoffs by Boeing and other companies in the region. The City recently added new retailers such as the Bon Marche and Staples Office Supply. Although the impact of these new merchants will not be seen until the third and fourth quarters of this year, these new businesses are expected to help boost the city's retail base. In addition, a new full service Marriott Hotel is scheduled to open, as is a new Canyon's Restaurant and Championship Motors in 2004.

While the local economy appears to be well positioned for future economic growth, the near term outlook remains tenuous. The city's economically sensitive revenues, sales taxes, development review fees and interest earnings, continue to be affected by the current slowdown. These revenues are either flat or have declined in comparison to last year. Since they make up nearly 50% of General Fund revenues, the lack of growth in these areas is a concern and has resulted in the Administration adopting a conservative approach to managing city resources.

To ensure that the city continues to operate within its revenue limits, City administration has taken several steps to control its costs. Strategies employed to date include: closely scrutinizing the use of overtime; filling vacancies only when they are absolutely necessary; negotiating and implementing health benefit cost containment measures which have served to stabilize the recent rise in employee benefit costs; and closely scrutinizing the use of professional services and other operational expenses. These strategies will remain in effect until such time there is clear evidence that the local economy and the city's economically sensitive revenues are improving. Since these strategies have been successful to date in reducing costs, the Administration believes that they will continue to serve the city well in the future.

### **General Fund**

At the end of the second quarter, the city continued to operate within its revenue limits. General Fund revenues totaled \$27.5 million compared to expenditures of \$21.9 million. Although sales taxes, development review fees and interest earnings were flat or declined in comparison to last year, this decline was entirely offset by the administration's prudent management strategies, which have been successful in lowering expenditures. Specifically, expenditures are running approximately 4% under budget at this point as departments continue to reap the benefits of cost containment measures put into effect early in the year. Because economic conditions can change quickly, it will be necessary to monitor both revenues and expenditures closely over the next few months to ensure that the city is well positioned to handle any major swings.

**Revenues:** General fund operating revenues at \$27.5 million compares to \$22.7 million for the same period last year. Highlights of revenue performance during the first six months of 2003 include the following:

- **Beginning fund balance.** The General Fund started the biennium with \$5.0 million. This balance includes \$3.3 million in funds that were carried forward from 1999-2000 and is presently being reserved in the event economic conditions worsens, as highlighted for Council during the 2003-04 budget. The remaining \$1.7 million represents funding that was set-aside in 2001-2002 for labor contracts that have not yet been settled and will be carried forward to 2003 for the same purpose.
- **Sales tax** revenues, which represent the largest single source of revenue for the General Fund, increased slightly over 2002 levels indicating that this revenue source has begun to stabilize. Contributing to this stabilization is growth in retail sales. This category was up 3.3% over 2002 primarily due to the addition of Home Depot and Fred Meyer. Offsetting this increase is a decline in construction related sales tax revenues, which are down 17% from previous year levels.

The following table shows how Redmond's sales tax has performed relative to surrounding jurisdictions.

**% Change in Sales Tax Collections: 2Q 2002 v 2Q 2003**

Renton	4.9%
Tukwila	3.0%
Kirkland	2.4%
Redmond	1.4%
Unincorporated King Co.	-2.3%
Seattle	-3.5%
Bellevue	-4.1%
Bothell	-7.6%

- **Property tax**, the city's second largest and most stable revenue source, is on target and within expectations for this time of the year.
- **Utility tax** revenues at \$4.2 million are in line with last year due to the timing of solid waste franchise fees, which offset a decline in natural gas utility tax revenue. Natural gas tax collections have declined due to the unseasonably warm weather and a reduction in rates, which took effect in mid 2002.
- **Development fees** related to commercial construction continue to decline. For example, in 2001-2002, a total of 1.4 million square feet of commercial development was constructed, approximately 50% of which was due to a single project (Microsoft Building 36). This compares to a total of 572,000 square feet of commercial building construction receiving building permits in 2003.

Residential building permit fees are up 44%, and are being fueled by historically low interest rates and active residential construction in the northern part of the City. Multifamily building permits are down 21% over the previous year, reflecting a decline in multifamily projects in the City. For example, between 2001-2002, a total of 1.1 million square feet of multifamily projects received building permits as compared to 150,000 square feet in 2003 with another 300,000 square feet that is under active site plan review. Projects that are currently under site plan review include the Fairwinds Retirement Center and Redmond 74.

- **Intergovernmental revenues** are on target. This category reflects monies received from Fire District 34, King County emergency medical services and state shared revenues such as motor vehicle fuel taxes and liquor sales.
- **Other revenues** totaled \$2.1 million and are comparable to levels collected last year. However, it is important to note that within this category, interest earnings are below budget and are offset by stronger than anticipated business license revenues resulting from a recently completed audit.

**Expenditures:** General Fund expenditures are 4% under budget for the first half of the year. Expenditures totaled \$21.9 million and compares to \$24.3 million for the same period in 2002. Departments continue to benefit from the cost containment strategies that were first put into place last year and continue today.

As of the end of the second quarter, all departments are well within their budget limits. As a rule of thumb, no department budget should be over 25% spent at this point. Expenditures range from a low of 15% - Legislative to a high of 23% - Planning, indicating that cost containment measures are working. Savings are primarily occurring in the salary and benefit areas as the city continues to scrutinize and hold open vacant positions, implement premium cost sharing for city employees and manage its overtime costs.

Please refer to the attached appendix for further detail on General Fund revenues and departmental expenditures.

### **Enterprise Funds**

**Water/Wastewater Utility:** The Water/Wastewater Utility ended the second quarter with a net operating loss of \$111,000 for the first six months as compared to a net operating loss of \$387,000 for the same period 2002. The improvement can be attributed to an increase in water sales as water consumption for in-city customers is up 7.2% when compared to the same period in 2002. The Utility operating position is expected to turn positive once higher water sales are recorded during peak summer usage, as has historically been the case.

Expenditures in Water/Wastewater Construction Fund totaled \$1,148,000 or 10.3% of budgeted levels compared to \$775,000 or 9.5% for the same period last year. Activity for this CIP program is expected to increase as additional projects complete design review and engineering analysis. Significant projects underway include reconstruction design of well number 5, rehabilitation of sewer pump station number 4, NE 80<sup>th</sup> Street/135<sup>th</sup> Avenue NE/83<sup>rd</sup> Street main replacement, Phase 1 of the meter vault/PRV upgrade and 2003 miscellaneous water system improvements.

**Stormwater Management Utility:** The Stormwater Management Utility continues to be financially healthy ending the first half of the year with net income of \$272,000 excluding the CIP surcharge. Revenues collected as part of the CIP surcharge totaled \$889,000 for the first six months and is consistent with expectations and levels collected in the past.

Expenses for the Stormwater Management Construction Fund totaled \$467,000 for the first six months of the year. Expenses in 2003 include rehabilitation of Idylwood Stream, which is nearing completion; construction for the Welcome Park retention pond; and continued construction design for the third phase of the rehabilitation of Upper Peters Creek.

**Urban Planned Development Utility:** Although the financial position for the UPD Utility continues to improve, the Utility incurred an operating loss for the first six months of 2003. The loss, which amounted to \$243,000 at the end of the second quarter compares to a \$437,000 loss

for the same period last year. The improvement in the Utility's operating position is due to: 1) an increase in water rates; 2) the implementation of a depreciation surcharge to fully fund the system in January of this year; and 3) higher consumption of water and sewer services as more homes are built and sold in Redmond Ridge. The financial condition of the Utility is expected to improve further with the opening of the Trilogy Golf course in May of this year, higher usage during the summer months and the build-out of the Redmond Ridge development

No major capital projects are planned for the Urban Planned Development Construction Fund. Expenses to date reflect a Regional Capital Facilities charge payable to the Cascade Water Alliance.

**Capital Investment Program (CIP):**

The City's CIP program is operating within its revenue constraints, with active construction occurring on several major projects throughout the City including improvements to Grass Lawn Park, construction of Perrigo Park, and West Lake Sammamish improvements.

For the first six months of the fiscal year, operating revenues totaled \$13.9 million, excluding beginning fund balances and operating expenditures were \$4.4 million. The following is a summary of the CIP's major revenue sources and expenditure activities.

- **Real Estate Excise Taxes (REET)** continue to be flat, consistent with the first quarter report. REET revenues totaled \$1.1 million or 25% of budgeted resources and were comparable to the amount collected for the same period last year. Current collections reflect continued weakness in commercial real-estate transactions. Moderately priced homes continue to be in demand fueled by historically low interest rates that have helped to keep this revenue source at par with the prior year.
- The City received \$3.9 million in **business tax revenues** compared to \$3.1 million in 2002. The increase in collections is attributable to an increase in the number of employees working in Redmond, as well as ongoing auditing of this activity.
- **Impact Fees revenues** total \$1.5 million and represent fees received for the Marriott Hotel at Town Center, Redmond Staples, Canyon's Restaurant, Emerald Heights expansion, Redmond 44, Evans Creek Building and several short plats around the community. Impact fees can vary significantly as these revenues are deposited into the CIP upon completion of projects.
- **Parks Bonds Loan Proceeds** in the amount of \$3.7 million were received from two loans that were authorized to finance improvements to Perrigo and Grass Lawn Parks.

The City spent approximately \$4.4 million of its CIP during the first half of the year with the largest expenditures in Transportation and Parks. The following highlights CIP activity by functional area.

- **Fire functional area** expenditure levels are consistent with last year. The majority of the expenditures in 2003 reflect transfers to the Fire equipment reserve and a minor amount for fire station security.
- **Transportation functional area** expenditures totaled \$2.9 million. Significant projects underway in 2003 include West Lake Sammamish Parkway rehabilitation and widening; Redmond Way / 132<sup>nd</sup> Avenue NE turn lane; 148<sup>th</sup> Avenue NE/NE 40<sup>th</sup> Street

improvements; 166<sup>th</sup> Avenue NE improvements; and 140<sup>th</sup> Avenue NE sidewalks improvements project.

- The **Parks functional area** spent \$1.2 million of its CIP during the first six months of the year. Significant expenditures during the period include expenses related to Grass Lawn Park Phase 2 and Perrigo Park construction, both of which are actively being constructed; improvements to the Teen Center; Burlington Northern Santa Fe (BNSF) Railroad Trail development; and Southeast Redmond Neighborhood Park construction.
- **General government functional area** used \$140,000 of its budget, the majority of expenditures going towards the purchase of affordable housing in association with the Eastside ARCH coalition. As the Council may recall, in late 2002, the Executive Board of ARCH proposed funds be raised from ARCH member cities for the acquisition and rehabilitation of a 66-unit apartment complex in downtown Kirkland. Redmond's share of this acquisition was \$100,000 with the remaining \$1.2 million generated by the cities of Bellevue, Kirkland, Mercer Island, Bothell and Issaquah.
- **Police functional area** expenditures are in line with expectations and reflect security upgrades to the Public Safety Building and continued implementation of Mobile Data Terminals in police vehicles.

Please refer to the attached appendix for further detail on CIP expenditures by functional area.

## CITYWIDE INVESTMENT REPORT

The city's investment portfolio continued to meet the primary objectives of the investment policy: safety of principal, liquidity of funds, and attaining a market rate of return given the risk constraints and diversification guidelines. The investment portfolio grew from \$114.9 million at the end of the 1st quarter to \$118.7 million at the end of 2nd quarter, a 3.3% increase. Revenue receipts and investment interest continue to push the balance of the portfolio higher.

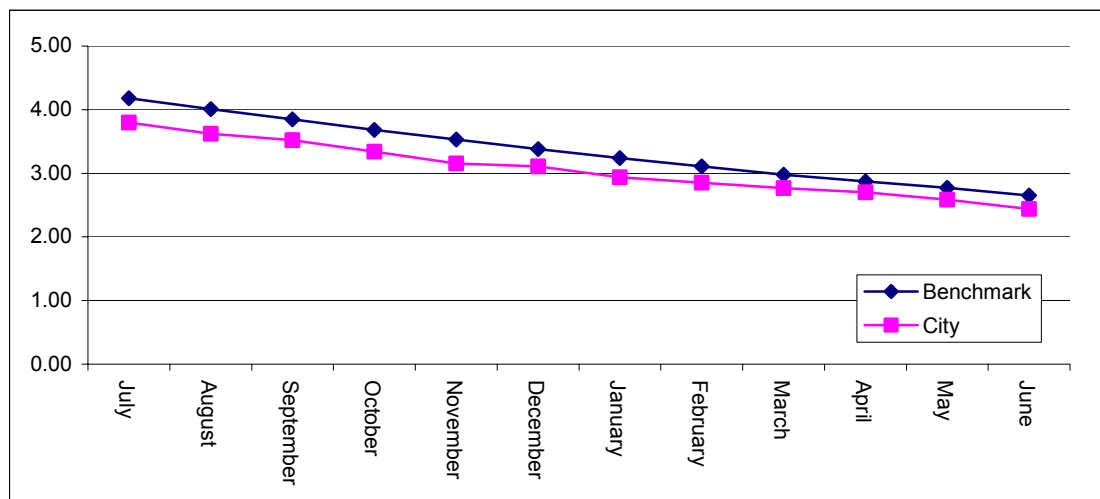
The table below shows the distribution of the city's investment portfolio and performance at June 30, 2003.

	Percentage of Portfolio	Days to Maturity	Yield To Maturity
Certificates of Deposit	40.1%	209	2.68%
Federal Agency Issues	38.3%	640	2.70%
State Investment Pool	17.8%	1	1.21%
Federal Agency Discount Issues	1.9%	361	3.93%
Money Market Fund	1.9%	1	N/A
<b>Total Value</b>	<b>100.00%</b>	<b>343</b>	<b>2.44%</b>

The city currently benchmarks its portfolio to the 2-year average of the 2-year Treasury note. During the 2<sup>nd</sup> quarter the city earned an average interest rate of 2.58% versus the benchmark average of 2.76%. The city slightly under performed its benchmark for the 2nd quarter of 2003 due to the continued decline of interest rates. In June the Federal Reserve Bank lowered the federal funds rate by 25 basis points to 1.00% in an effort to spur sustainable growth in the economy. The market's anticipation of the Federal Reserve's action directly affected the investment yields the city was able to obtain. Once interest rates begin to increase, the city will be in a good position to once again meet or exceed its benchmark.

The following chart compares the city's rate of return to the benchmark for the past twelve months.

Portfolio Benchmark Comparison  
July 2002 – June 2003



## **Appendix**



**EXHIBIT 1**  
**General Fund Revenues and Expenditures**  
**For the Six Months Ending June 2003**

<b>REVENUE COLLECTIONS</b>	<b>2003-04 Budget</b>	<b>2003 Jan-Jun</b>	<b>% Received</b>	<b>2002 Jan-Jun</b>
<b>Beginning Fund Balance</b>	\$ 0	\$ 5,037,773	0.0%	\$ 0
<b>Sales Taxes</b>	34,950,000	7,222,787	20.7%	7,120,264
Less Sales Tax on Construction	(2,200,000)	(550,002)	25.0%	(550,002)
<b>Sales Tax - Criminal Justice</b>	1,940,000	424,965	21.9%	425,844
<b>Property Taxes</b>	20,076,000	5,098,873	25.4%	4,913,446
<b>Utility Taxes</b>				
Electricity	7,394,000	1,733,231	23.4%	1,716,455
Telephone	7,447,000	1,620,782	21.8%	1,564,216
Natural Gas	1,998,000	405,909	20.3%	611,420
Garbage Collection	921,000	219,727	23.9%	95,770
Cable Television	904,000	226,424	25.0%	201,428
Subtotal: Utility Taxes	18,664,000	4,206,073	22.5%	4,189,289
<b>Development Fees</b>	7,914,000	1,535,368	19.4%	2,260,379
<b>Intergovernmental</b>				
Fire & Emergency Services	9,286,000	695,616	7.5%	653,974
Overhead Fees	4,576,000	1,127,500	24.6%	1,092,353
Motor Vehicle Fuel Taxes	1,366,000	309,798	22.7%	309,278
Motor Vehicle Excise Taxes	0	0	0.0%	0
Liquor Profits & Taxes	812,000	237,868	29.3%	216,114
Federal/State/Local Grants and Paym	382,000	26,490	6.9%	25,349
Subtotal: Intergovernmental Revs	16,422,000	2,397,272	14.6%	2,297,068
<b>Other</b>				
Investment Interest	2,450,000	251,086	10.2%	556,417
Business Licenses	1,567,000	914,470	58.4%	720,755
Business License Penalties	60,000	368,693	614.5%	36,893
Admissions Tax	903,000	190,361	21.1%	163,704
Fines and Forfeitures	294,000	105,299	35.8%	128,985
Licenses and Permits	132,700	57,418	43.3%	47,487
Other	459,000	227,776	49.6%	434,139
Subtotal: Other Revenues	5,865,700	2,115,103	36.1%	2,088,380
<b>TOTAL OPERATING REVENUE:</b>	<b>\$ 103,631,700</b>	<b>\$ 27,488,212</b>	<b>26.5%</b>	<b>\$ 22,744,668</b>

<b>DEPARTMENTAL EXPENDITURES</b>	<b>2003-04 Budget</b>	<b>2003 Jan-Jun</b>	<b>% Spent</b>	<b>2002 Jan-Jun</b>
Fire	\$ 21,177,047	\$ 4,669,119	22.0%	\$ 5,194,995
Police	19,819,528	4,133,910	20.9%	4,686,212
Non-Departmental	15,876,689	2,697,549	17.0%	2,877,061
Public Works	15,183,023	3,424,594	22.6%	4,008,467
Finance and IS	9,856,923	2,193,880	22.3%	2,312,205
Planning	9,290,503	2,151,123	23.2%	2,355,380
Parks & Recreation	8,254,954	1,826,876	22.1%	1,909,358
Human Resources	1,686,945	329,244	19.5%	373,442
Legal	1,200,031	233,500	19.5%	318,556
Executive	971,201	215,452	22.2%	198,504
Legislative	314,856	47,408	15.1%	51,715
<b>TOTAL EXPENDITURES</b>	<b>\$ 103,631,700</b>	<b>\$ 21,922,655</b>	<b>21.2%</b>	<b>\$ 24,285,895</b>

**EXHIBIT 2**  
**Utility Revenues and Expenditures**  
For the Six Months Ending June 2003

<b>Water/Wastewater Utility</b>	<b>2003 Jan-Jun</b>	<b>2002 Jan-Jun</b>
Operating Revenues		
Rates and Services	4,295,756	3,965,134
Metro Wastewater Treatment	3,397,293	3,245,114
<b>Total Operating Revenues</b>	<b>7,693,049</b>	<b>7,210,248</b>
Operating Expenses		
Administration and Operations	3,822,486	3,501,796
Purchased Water	503,898	504,653
Payment for Metro Wastewater Treatment	3,477,329	3,590,816
<b>Total Operating Expenses</b>	<b>7,803,713</b>	<b>7,597,265</b>
<b>Operating Income/(Loss)</b>	<b>(110,664)</b>	<b>(387,017)</b>
<b>CIP Expenditures</b>		
<b>Water/Wastewater CIP</b>	<b>1,148,884</b>	<b>775,136</b>
<b>Stormwater Mgmt Utility</b>	<b>2003 Jan-Jun</b>	<b>2002 Jan-Jun</b>
Operating Revenues		
Rates and Services	2,570,101	2,554,469
<b>Total Operating Revenues</b>	<b>2,570,101</b>	<b>2,554,469</b>
Operating Expenses		
Administration and Operations	2,297,288	2,026,614
<b>Total Operating Expenses</b>	<b>2,297,288</b>	<b>2,026,614</b>
<b>Operating Income/(Loss)</b>	<b>272,813</b>	<b>527,855</b>
<b>CIP Expenditures</b>		
<b>Stormwater Mgmt CIP</b>	<b>467,578</b>	<b>593,490</b>
<b>UPD Utility</b>	<b>2003 Jan-Jun</b>	<b>2002 Jan-Jun</b>
Operating Revenues		
Rates and Services	619,515	307,978
Metro Wastewater Treatment	104,265	68,859
<b>Total Operating Revenues</b>	<b>723,780</b>	<b>376,837</b>
Operating Expenses		
Administration and Operations	805,254	748,370
Purchased Water	57,147	21,260
Payment for Metro Wastewater Treatment	104,265	44,511
<b>Total Operating Expenses</b>	<b>966,666</b>	<b>814,141</b>
<b>Operating Income/(Loss)</b>	<b>(242,886)</b>	<b>(437,304)</b>
<b>CIP Expenditures</b>		
<b>UPD Utility CIP</b>	<b>153,134</b>	<b>26,050</b>

**EXHIBIT 3**  
**Capital Investment Program Revenues and Expenditures**  
**For the Six Months Ending June 2003**

<b>REVENUE CATEGORIES</b>	<b>2003-04 Budget</b>	<b>2003 Jan-Jun</b>	<b>% Received</b>	<b>2002 Jan-Jun</b>
General Fund	\$ 5,389,195	\$ 1,368,415	25%	\$ 1,686,918
Real Estate Excise Tax (REET)	4,229,055	1,059,685	25%	1,150,000
Sales Tax on Construction	2,200,000	550,002	25%	550,002
Business Tax	12,761,116	3,959,056	31%	3,115,231
Impact Fees	5,191,000	1,522,208	29%	0
Private Contributions	405,280	722,027	178%	3,383,217
Federal/State Grants	5,880,126	0	0%	163,198
Investment Interest	2,528,003	823,162	33%	1,285,611
City Campus Project Revenue [1]	3,494,659	0	0%	0
Vehicle registration fees - local Option	800,000	9,992	1%	204,450
Half-cent motor vehicle fuel tax	624,000	144,851	23%	144,608
Parks Bonds Loan Proceeds	0	3,698,472	0%	0
Other Revenue [2]	4,643,938	86,181	2%	7,631
<b>Major Revenue Source Subtotal</b>	<b>48,146,372</b>	<b>13,944,051</b>	<b>29%</b>	<b>11,690,866</b>
Beginning Fund Balance	46,499,575	46,454,304	100%	0
<b>TOTAL CIP REVENUES</b>	<b>\$ 94,645,947</b>	<b>\$ 60,398,355</b>	<b>64%</b>	<b>\$ 11,690,866</b>

[1] Reflect Utility and LID Guaranty Fund resources.

[2] Other revenue includes interfund transfers, intergovernmental revenue, and rental from parks houses.

<b>CIP FUNCTIONAL AREA</b>	<b>2003-04 Budget</b>	<b>2003 Jan-Jun</b>	<b>% Spent</b>	<b>2002 Jan-Jun</b>
<b>EXPENDITURES</b>				
Fire CIP	\$ 1,963,541	\$ 120,695	6.1%	\$ 182,009
Transportation CIP	43,514,643	2,888,707	6.6%	4,976,384
Parks CIP	18,274,705	1,248,053	6.8%	1,242,376
General Government CIP	15,031,448	140,387	0.9%	44,008
Police CIP	3,173,690	36,454	1.1%	74,014
<b>Total CIP Expenditures Subtotal</b>	<b>81,958,027</b>	<b>4,434,296</b>	<b>5.4%</b>	<b>6,518,791</b>
Ending Fund Balance	12,687,920			
<b>TOTAL CIP EXPENDITURES</b>	<b>\$ 94,645,947</b>			